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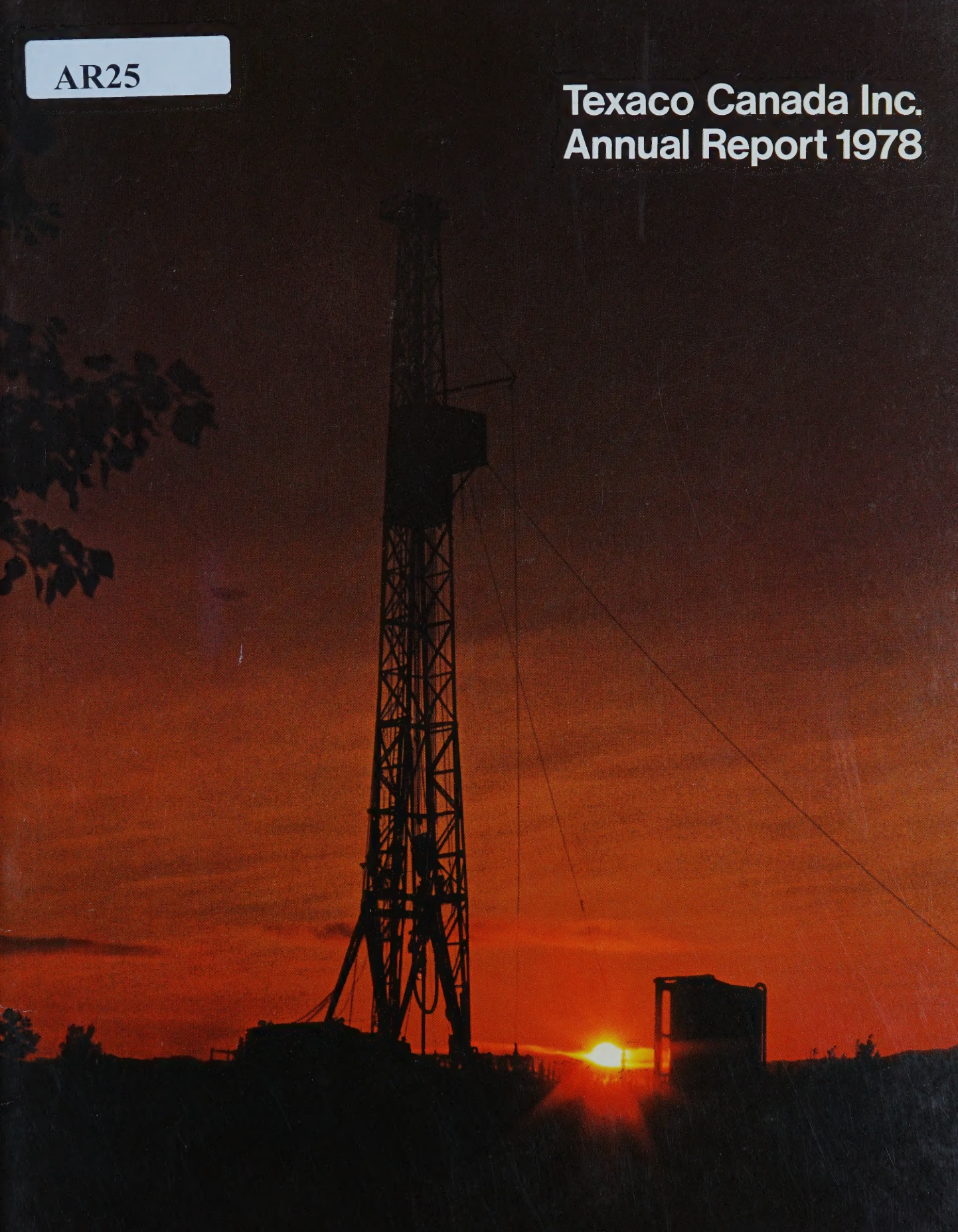
Texaco Canada Inc.
Annual Report 1978



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Subsidiary Companies

Regent Refining (Canada) Limited
Tolhurst Petroleum Ltd.
Independent Petroleum (1970) Ltd.
Chartier Petroleum Ltd.
McColl-Frontenac Oil Co. Ltd.
Public Fuel Transmission Systems Limited
Oilship Limited
The Great Eastern Oil & Import Co. Limited
La Société Acadienne de Recherches Pétrolières Ltée
Lowry Fuels Limited

Principal Investments and Percentage Interest

Federated Pipe Lines Ltd.	50%
Trans-Northern Pipe Line Company	33.33%
Alberta Products Pipe Line Ltd.	20%
Montreal Pipe Line Company Limited	16%

Officers

R. W. Sparks
President and Chief Executive Officer

James E. Brazell
Executive Vice-President

J. L. Morrison
Executive Vice-President

O. C. Cleyn
Vice-President, Eastern Canada and Region Manager

A. J. Galipeault
Vice-President and General Counsel

H. T. Hudson
Vice-President and Assistant to the President

D. E. Hyer
Vice-President and General Manager, Exploration and Producing

G. T. Plunkett
Vice-President and Treasurer

J. C. Wattie
Vice-President, Corporate Planning and Services

E. J. Little
Secretary

D. L. West
Comptroller

O. C. Windrem
Corporate Tax Officer

Texaco Canada Inc.
90 Wynford Drive
Don Mills, Ontario M3C 1K5

Transfer Agents in Canada:
Montreal Trust Company,
Montreal, Toronto, Winnipeg,
Regina, Calgary and Vancouver

Registrars in Canada:
The Royal Trust Company,
Montreal, Toronto, Winnipeg,
Regina, Calgary and Vancouver

Transfer Agents and Registrars in the United States:
The Royal Bank & Trust Company
68 William Street, New York, N. Y.

On peut obtenir un exemplaire français du présent rapport annuel en s'adressant au secrétaire de la compagnie,
90 Wynford Drive
Don Mills, Ontario M3C 1K5

The Annual Meeting of Shareholders of Texaco Canada Inc. will be held at the Company's head office at 90 Wynford Drive, Don Mills, Ontario, on Friday, April 20, 1979, at 10:45 a.m.

Cover: Texaco drilling rig at Elmworth, Alberta, stands in stark relief against sunset sky.

The use in this report of such terms as *Texaco Canada, Corporation, Company, organization, we, us, our* and *its,* when referring to Texaco Canada Inc. or to its subsidiaries and affiliates either individually or collectively, is only for convenience and is not intended to be an accurate description of corporate relationships.

Highlights

Financial

	1978	1977
	Millions of Dollars	
Gross Income	$1,929	$1,735
Net Income	148	150
*Total Cash dividends	44	48
Funds provided by operations	280	209
Taxes and crown royalties	698	668
Total capital employed at year-end	1,484	1,284
Shareholders' equity at year-end	1,095	993
Working capital at year-end	263	362
Long-term debt at year-end	100	100
Capital and exploratory expenditures	354	221

Rate of Return

On average capital employed	11.5%	13.2%

Per Common Share Data

Net Income	$ 4.19	$ 4.25
Funds provided by operations	9.30	6.94
Shareholders' equity at year-end	26.61	23.21

Operating

	Thousands of barrels daily	
Gross production of crude oil and natural gas liquids	123	124
Refinery runs	164	158
Petroleum product sales	193	188
Natural gas sales (millions of cubic feet daily)	72	86

*Dividends paid on common shares after June 1, 1978 were at the same quarterly rate of $0.39 a share as previously paid by Texaco Canada Limited — equivalent to an annual rate of $1.56 a share.

All data is on an amalgamated basis. See Note 1 to the consolidated financial statements.

To the Shareholders

Fundamental organizational and other changes took place in 1978 which will have a positive influence upon the future growth and progress of the company.

The amalgamation of Texaco Canada Limited and Texaco Exploration Canada Ltd. into one corporation now bearing the name Texaco Canada Inc. had the immediate effect of creating a much larger company. Texaco Canada had been engaged primarily in the refining and marketing of petroleum products and Texaco Exploration mainly in exploration for and production of crude oil and natural gas. The single corporation which resulted from the amalgamation possesses strong financial resources, better balance in its operations, and substantial oil and gas reserves. The amalgamated company, one of the largest producers of crude oil and natural gas liquids in Canada, supplied some 7½% of the country's total demand in 1978.

Another achievement of major importance to the company in 1978 was the completion and start-up, in November, of the new "grassroots" refinery at Nanticoke, Ontario. This refinery, with a rated capacity of 95,000 barrels a day and built at a cost of about $480 million, was the largest single project ever undertaken by the company. Designed to process a full range of petroleum products, the plant enables the company to meet its Ontario market requirements without the need for costly supplementary supplies from non-company sources.

Operations at Port Credit refinery were substantially reduced following the start-up of Nanticoke. The inactive portion of the plant is being kept in readiness, however, to provide additional processing capacity if required.

R. W. Sparks

The Industry

Exploration and development activities in the petroleum industry in Canada were at a high level in 1978, particularly in the conventional areas of the Western Provinces. Expenditures, the number of drilling rigs at work, and the footage drilled are all expected to exceed previous levels.

The stepped-up activities resulted in part from the industry's success in finding, through deeper drilling, new oil reserves in the West Pembina area and substantial gas reserves in the Elmworth region of Alberta. Texaco Canada participated in a significant number of discoveries in both of these areas, but the full extent of the additional reserves will have to be determined by further drilling.

Although domestic demand was at about the same level as in the previous year, the further mandatory reduction in exports to the United States resulted in a small overall decline in the total production of crude oil and natural gas liquids in Canada.

The petroleum products segment continued to feel the adverse effects of under-utilization of the industry's refining capacity. This was particularly evident in the larger market areas of the eastern half of the country where intense competition continued to be reflected in soft prices. Some of this capacity — which could be used for processing crude for others, thereby helping Canada's balance of trade position and contributing some value-added manufacturing benefits — remained idle because of various governmental regulations and other restrictions.

The force-feeding of Western Canada natural gas into markets east of Montreal, a subject of much discussion in 1978, is a concept which should receive more careful and critical examination before any commitments are made.

It appears unlikely that the proposed project would be economically viable considering the high cost of the main line and distribution system and the limited markets to be served by these facilities. Exports of natural gas to U.S. markets through pipeline facilities already in place would provide an economic alternative to this proposal.

Government incentive programs, particularly by the province of Alberta and by the Federal Government in connection with "frontier" exploration and drilling, are contributing significantly to the increased pace of the search for new oil in Canada.

One tangible demonstration of the beneficial effects of the latter program, for example, has been the decision by Texaco Canada, as the operator, together with a group of other companies participating in the project, to proceed with plans for the drilling in the summer of 1979 of a test well in the Atlantic, some 300 kilometres northeast of St. John's, Newfoundland. There has never been a well drilled in water this deep anywhere in the world.

If, however, the enormous amounts of risk capital

and the stable investment and planning conditions needed to help improve Canada's security of energy supply position over the longer term are to be obtained, close co-operation between the petroleum industry, the financial community and governments will be essential, and additional incentives will be required.

In particular, the existing federal incentives for high-risk frontier exploration and development should be extended beyond the presently planned expiry date of April, 1980.

Increased federal and provincial incentives to stimulate construction of the plants and facilities needed to extract the vast domestic resources of bitumen and heavy oil deposits are also urgently needed.

The level and pattern of petroleum consumption in 1978 suggests that Canadians, who are already among the highest consumers of petroleum per capita in the world, should give higher priority to conservation of this depleting and increasingly valuable resource.

Capital and Exploratory Expenditures

Texaco Canada's capital and exploratory expenditures over the last five years total more than $1 billion. In 1978 alone these outlays amounted to $353.8 million, an increase of 60% over the previous year.

The company expects that its capital and exploratory outlays in the coming years will remain high in keeping with its objectives of aggressively pressing the search for new Canadian reserves of oil and gas and of providing facilities to manufacture and market quality products in the needed quantities and at the lowest practical cost.

Financial and Operating Results

The company's net income of $147.9 million, or $4.19 a share, for 1978 was some 1% below the level of the previous year.

Dividends paid on common shares were at a rate of 39 cents a quarter throughout 1978. In the first quarter of 1979 a dividend of 42 cents was paid, an increase of 3 cents over the rate for the previous quarter.

Capital employed by the company was at a level of nearly $1.5 billion at year-end, an increase of about $200 million over the previous year. The rate of return on average capital employed was 11.5%, down from 13.2% for 1977. This decrease reflects primarily an inadequate rate of return from refining and marketing operations.

The company increased its exploration activities in 1978 and attained a high degree of success in both exploratory and development drilling.

Production of petroleum liquids averaged 122,800 barrels daily in 1978, slightly less than in the previous year. Natural gas sales averaged 71.5 million cubic feet a day, a reduction of approximately 16%.

Sales of the company's products averaged 192,500 barrels daily, an increase of about 3% over the previous year. Refinery runs averaged 163,600 barrels daily, up 4% over 1977.

Directors, Officers, and Other Senior Officials

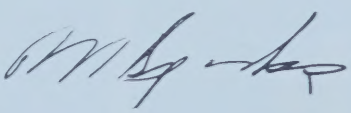
During 1978 the number of Directors of the company was increased from 15 to 16, and two new Directors were elected. They are F. Augustus Seamans, Vice-President, Exploration and Producing Services of Texaco Inc. and James E. Brazell, previously an officer of Texaco Exploration Canada Ltd., who was elected an Executive Vice-President of Texaco Canada Inc. John I. Mingay did not stand for re-election to the Board of Directors. Mr. Mingay served Texaco Canada Limited with distinction as President and Chief Executive Officer from November 1972 to October 1975 and as a Director over two stages: from 1961 to 1963 and from 1971 until May, 1978.

H. T. Hudson was elected Vice-President and Assistant to the President, and was succeeded as Vice-President and Treasurer by George T. Plunkett. Donald E. Hyer was elected Vice-President and General Manager, Exploration and Producing (Calgary) and Orville C. Windrem was appointed Corporate Tax Officer at Executive Offices. Also during 1978, John G. Light, Vice-President, Refining retired from the company after 40 years of dedicated service. Lloyd W. Kennedy, General Manager, Refining, was appointed head of the Department.

Effective March 1, 1979, J. C. Wattie, previously Vice-President and General Manager, Marketing, became Vice-President, Corporate Planning and Services. Norman E. Taylor was appointed General Manager, Marketing, and Stuart J. Walker, General Manager, Supply and Distribution.

The Board of Directors, in recording its appreciation to the employees for their skillful and dedicated efforts and to shareholders and customers for their continued support and loyalty in 1978, also wants to express confidence in the ability of the amalgamated company to be a more dynamic force in the Canadian oil and gas industry in the years ahead.

Respectfully submitted on behalf of the Board of Directors,



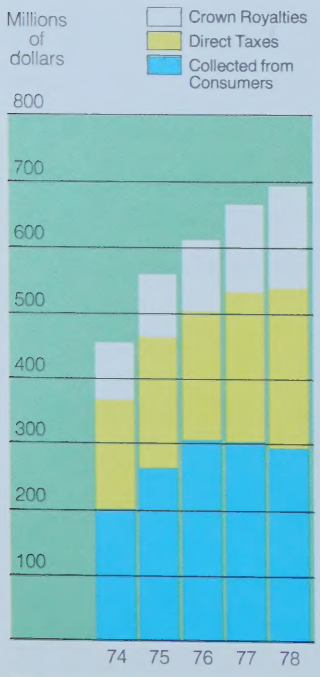
R. W. Sparks
President and Chief Executive Officer

Don Mills, Ontario
March 20, 1979

Financial Review

Net Income and Dividends

Taxes and Crown Royalties



For accounting purposes all financial data is presented in this Annual Report on a uniform basis as though the amalgamation had taken place at the beginning of the periods described.

Earnings and Dividends

Texaco Canada's consolidated net income for 1978 was $147.9 million compared with $149.6 million in 1977. Income per common share amounted to $4.19, compared with $4.25 in the previous year.

The marginal decline in net income reflected mainly soft prices for petroleum products which prevailed through the year and other adverse pressures on income. These negative factors included two 60-day product price freezes imposed by governments, lower sales of natural gas and the continuing pressure of inflation on operating costs.

Cash dividends paid to shareholders amounted to $43.8 million representing 30% of the net income for the year, compared with $48.2 million or 32% in 1977.

Dividends paid on the company's common shares after June 1st were at the same quarterly rate of $0.39 per share as previously paid by Texaco Canada Limited. Nineteen seventy-eight was the 34th consecutive year in which dividends have been paid on the company's common shares.

Gross income for the year amounted to $1,929.3 million, compared with $1,734.6 million in 1977. This increase of $194.7 million, or 11%, was due principally to the higher volume of products sold and to general increases in product prices which partially offset two nationwide increases in the cost of crude oil.

Total costs and expenses were $1,781.4 million in 1978, compared with $1,585.0 million in the previous year. This increase of $196.4 million, or 12%, resulted primarily from higher crude oil costs. The federal and provincial governments increased crude prices by $2.00 per barrel during the year, one half of which went into effect on January 1 and the remainder on July 1.

Higher levels of activity in oil and gas exploration and producing operations, in refining and marketing operations, as well as continuing inflationary pressure, also added significantly to higher costs and expenses.

Continuing programs instituted by the company to increase efficiency and reduce costs in all phases of its operations served to lessen, but did not fully offset, the increased upward pressure on costs.

Taxes and Crown Royalties

Total taxes and crown royalties paid or accrued, including taxes collected from consumers for governmental agencies in 1978 amounted to $698.3 million. This was an increase of $30.7 million or 5% compared with $667.6 million in 1977. These amounts consist of direct taxes including current and deferred income taxes, property taxes, import duties, mineral taxes and levies of $243.2 million, compared with $232.2 million in 1977. Oil and gas production crown royalties were $158.3 million, compared with $133.4 million in 1977. In addition, taxes levied on the consumer and collected by the company on behalf of federal and provincial governments amounted to $296.8 million in 1978, compared with $302.0 million for the previous year.

The decrease in the taxes collected from consumers was due to the reduction in the excise tax on motor gasoline by the federal government to 7 cents per gallon from the previous 10 cents, and to the elimination of road tax on motor gasoline by the province of Alberta.

Total taxes and crown royalties paid or accrued to government agencies were equivalent to nearly 5 times the company's net income in 1978.

Assets and Capital Employed

Total assets of the company at December 31, 1978 amounted to $1,722.4 million, compared with $1,556.9 million at the end of 1977.

Total capital employed at year-end increased to $1,483.6 million from $1,283.5 million a year earlier.

Working capital at the end of 1978 was $263.2 million, compared with $361.7 million at the end of 1977.

Net fixed assets and other investments increased to $1,220.4 million from $921.8 million a year earlier. Investment in the Nanticoke refinery and the purchase from Texaco Inc. of certain capital assets, which were subsequently leased back, accounted for a substantial portion of this increase.

The rate of return on average capital employed during 1978 was 11.5% compared with 13.2% in the previous year. This decrease largely reflects the company's inability to fully recover its increased costs because of competitive pressure on product prices.

Total shareholders' equity at the end of 1978 amounted to $1,095.3 million compared with $992.7 million a year earlier.

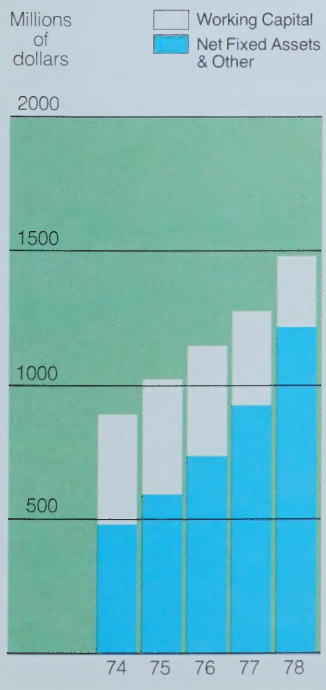
Funds Provided by Operations

Funds provided by operations of the company prior to the deduction of exploratory expenditures charged against current earnings, amounted to $301.3 million in 1978 compared with $220.8 million in 1977. After deduction of these charges, funds provided by the company's operations amounted to $280.0 million and $208.9 million in 1978 and 1977 respectively.

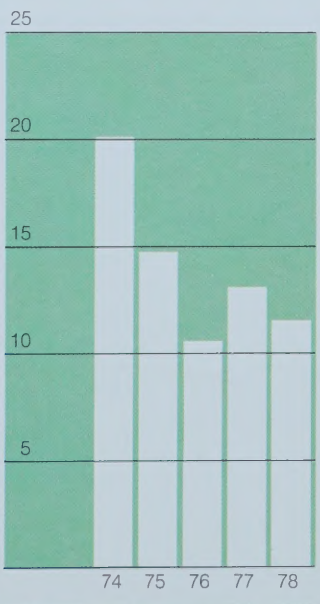
Capital and exploratory expenditures reached a record level of $353.8 million, or nearly 60% over the $221.4 million in 1977.

	Millions of dollars	
	1978	1977
Total capital and exploratory expenditures	**353.8**	221.4
Deduct: exploratory expenditures charged against current earnings	**21.4**	11.8
Total expenditures capitalized	**332.4**	209.6

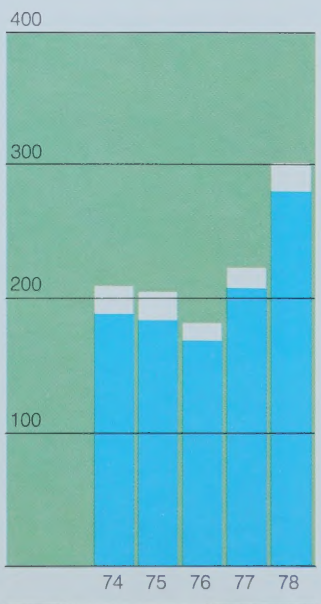
Capital Employed



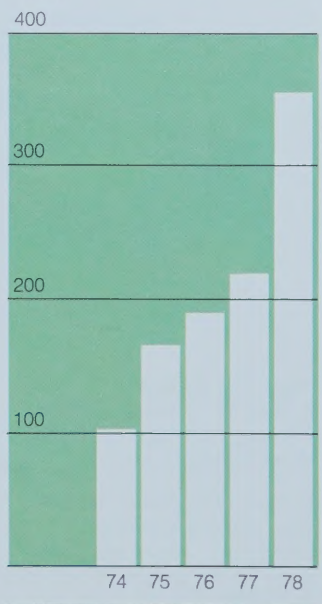
Rate of Return on Capital Employed



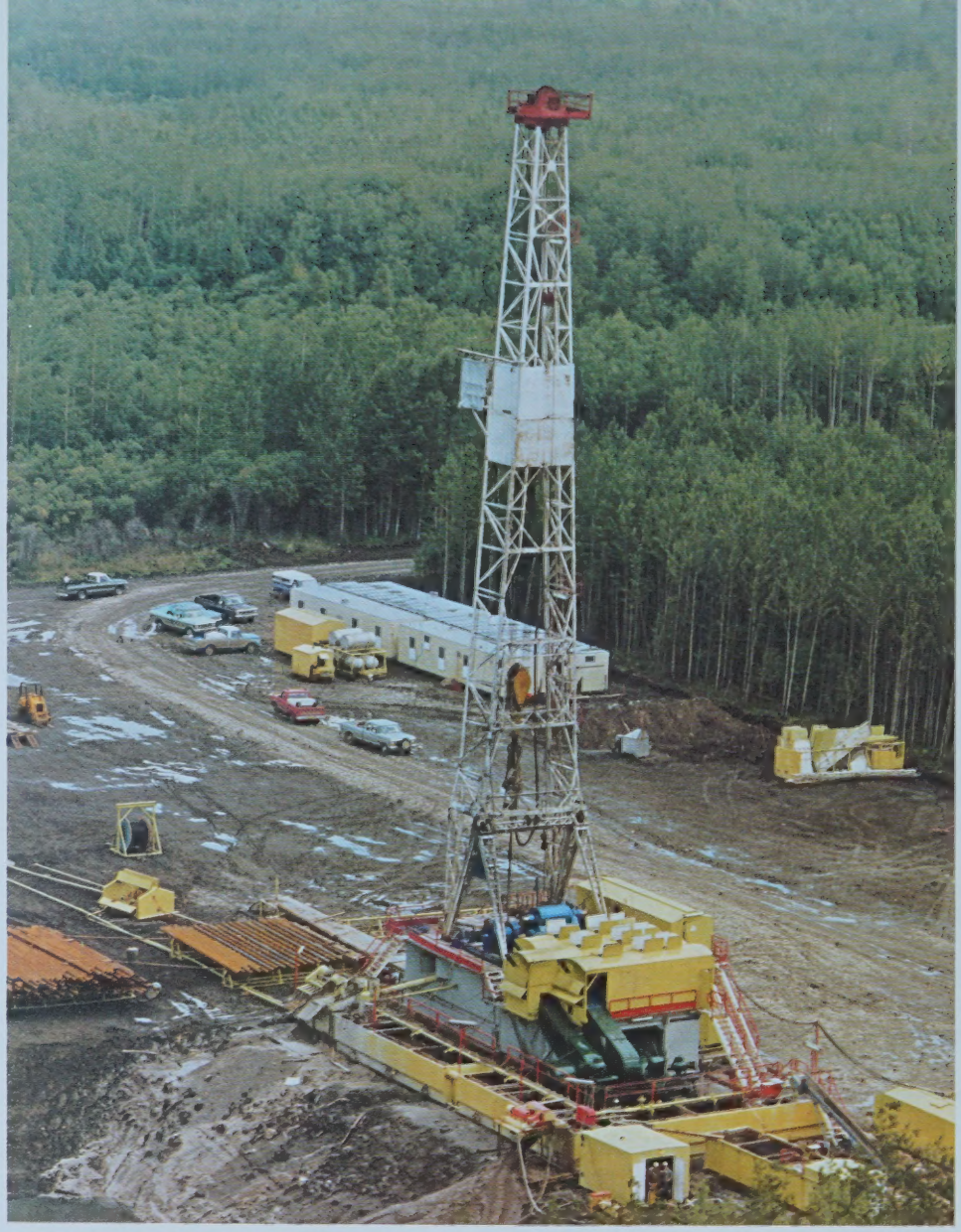
Funds Provided by Operations



Capital and Exploratory Expenditures



Review of Activities



Top: This wildcat well was one of 17 in which Texaco Canada participated in the West Pembina area.

Bottom: Athabasca tar sand pilot project near Fort McMurray, where the company holds leases on 575,000 net acres.

Exploration and Production

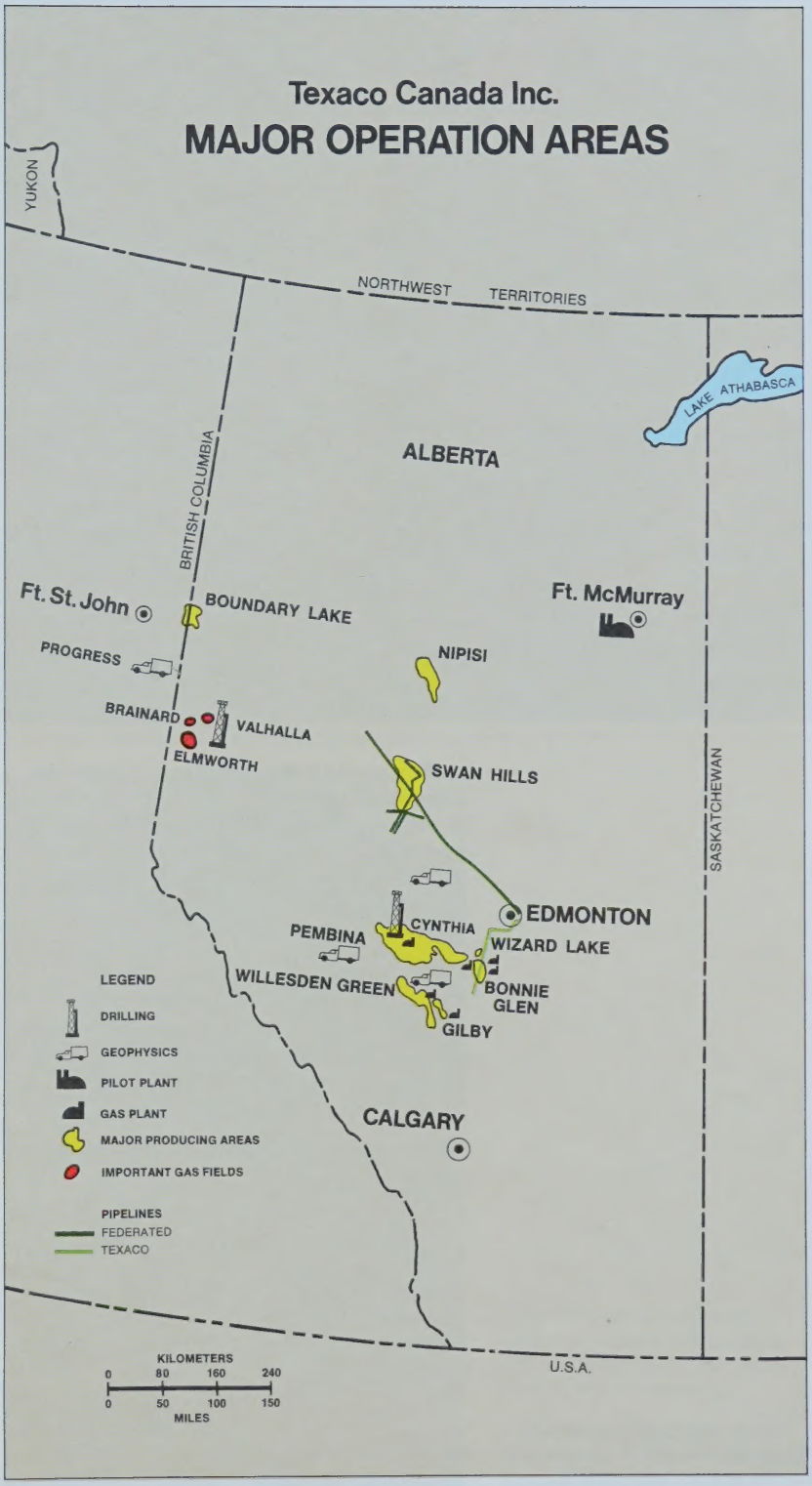
Exploration

During 1978 Texaco Canada operated six contract geophysical crews. Four of these were located in the high priority areas of Alberta, including West Pembina, one was in the Progress area of Northeast British Columbia and the other operated off the East Coast conducting some 80 miles of marine seismic work over the Scotian Shelf. In the West Pembina region of Alberta, the company obtained about 3,550 miles of seismic control data. Results of this program were of assistance in carrying out a highly successful exploratory drilling program.

The company's exploratory drilling activities were concentrated in West Pembina and Elmworth. In the West Pembina area Texaco Canada participated in the completion of 17 wildcat wells, resulting in 14 oil and one gas discovery. In the Deep Basin gas play of West Central Alberta centering around the Elmworth area, the company participated in the completion of nine wildcat wells resulting in eight gas discoveries.

Acreage

Texaco Canada expanded its already substantial holdings in the West Pembina area during the year by acquiring an interest in an additional 4,800 acres, bringing its total holdings in this area to 140,000 gross acres. Landholdings were also increased in the Elmworth Deep Basin area.



Wildcat Drilling

Number of wells

	1978		1977	
	Gross	Net	Gross	Net
Oil	**15**	**8.5**	—	—
Gas	**10**	**4.5**	19	10.1
Dry	**3**	**2.0**	3	1.7
Total	**28**	**15.0**	22	11.8
% Productive	**89**	**87**	86	86

Texaco geologist (centre) participates in core recovery at West Pembina wildcat.

At year-end the company's landholdings totalled some 12.9 million gross acres, compared with 14.8 million acres at the end of 1977. During 1978 the company surrendered certain landholdings which were no longer regarded as prospective.

Production

Texaco Canada is one of the largest producer of petroleum liquids in Canada. The company's production is derived principally from a few major fields in Alberta, while lesser amounts come from

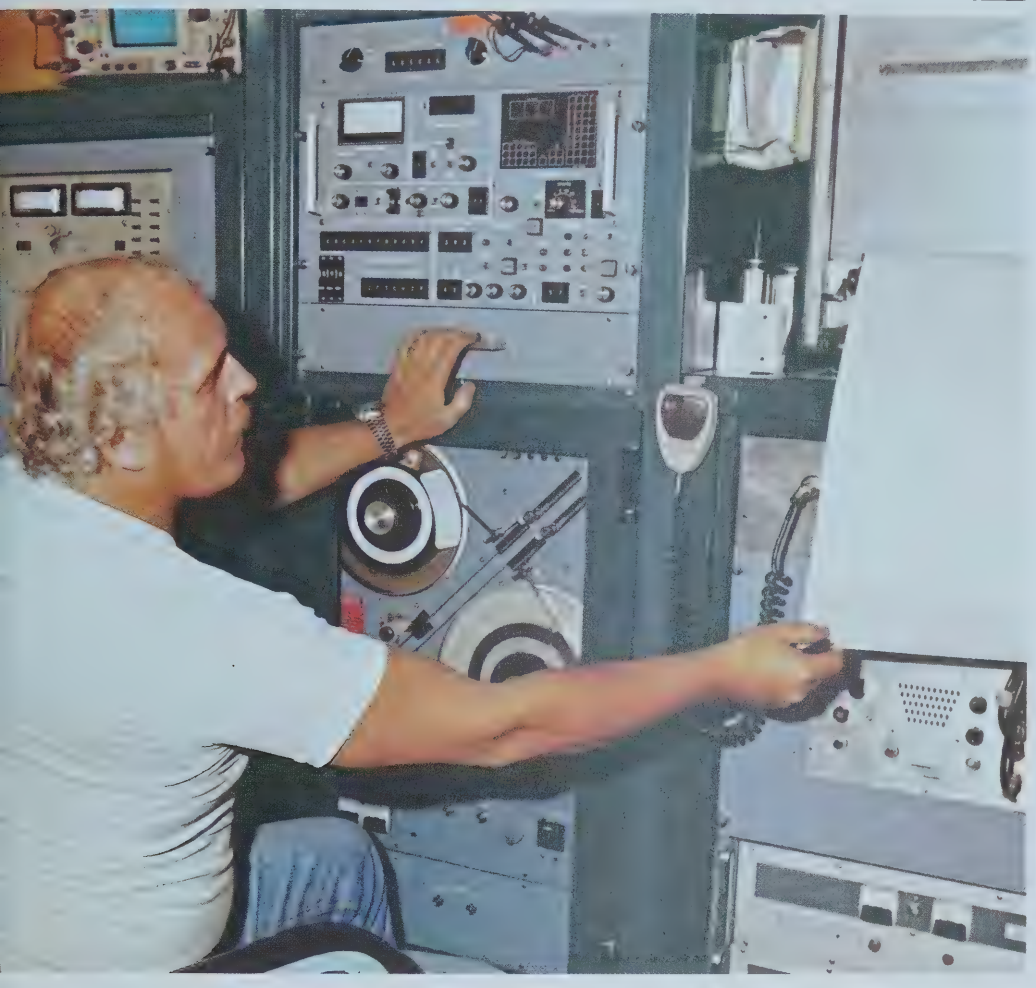
Landholdings

	Thousands of acres as at December 31, 1978	
	Gross	Net
Western Provinces	3,474	2,273
Beaufort Sea	1,421	1,305
East Coast	5,640	5,312
*Other	2,229	1,562
Coal	128	128
Total	12,892	10,580

*Includes Arctic Islands, N.W.T. & Yukon

Gross Production of Crude Oil and Natural Gas Liquids

	Thousands of barrels daily	
	1978	1977
Alberta		
Bonnie Glen	**34.4**	34.0
Nipisi	**4.7**	4.4
Pembina	**10.7**	9.3
Swan Hills	**13.2**	13.9
Wizard Lake	**34.9**	34.6
Other	**9.5**	10.9
Total	**107.4**	107.1
British Columbia	**1.6**	1.9
Manitoba & Saskatchewan	**1.4**	1.4
Natural Gas Liquids	**12.4**	13.2
Total Production	**122.8**	123.6



fields located in the other three western provinces.

Gross production from all fields declined slightly to 122,800 barrels a day in 1978 from an average of 123,600 barrels a day in 1977. Although production of crude oil was at about the same level as a year ago, production of natural gas liquids decreased due to lower demand for the company's natural gas. Sales of natural gas averaged 71.5 million cubic feet a day in 1978, compared with 85.7 million in 1977.

Development

The company participated in the drilling of 91 development wells in 1978, eight of which were successfully completed as oil wells and 79 as gas wells. Included in this drilling activity were three Nisku development wells in the West Pembina area, all of which were producing oil wells.

In the Deep Basin area around Elmworth, Texaco Canada participated in the drilling of 12 development wells,

Top: Instrument operator records seismic reflections from underground detonation at West Pembina.

Left: Texaco engineer and foreman at Elmworth discuss drilling progress chart.

six of which were gas wells. Four are still being evaluated. In addition, three development wells currently are being drilled. As a result of this drilling activity the company has succeeded in making a significant addition to its reserves of natural gas. With the completion of a gas gathering and processing facility now under construction, gas sales from this area are expected to commence in the latter part of 1979.

Reserves

Texaco Canada's gross reserves of crude oil and natural gas liquids at the end of 1978 were estimated at 539 million barrels. Reserves declined by 26 million barrels from the level at the end of 1977 because withdrawals exceeded the amount added by the company to its reserves as a result of extensions of existing fields and new discoveries. The full extent to which discoveries at West Pembina improved the company's reserves of crude oil will not be known until further planned development work is carried out. Early indications, however, are that the West Pembina Nisku play could result in over 100 million barrels of oil reserves for the company.

Estimated gross reserves of natural gas were 1,933 billion cubic feet at the end of 1978, an increase of 40 billion cubic feet over 1977, as new discoveries, resulting mainly from the successful drilling programs at Elmworth, exceeded the amount of natural gas withdrawn for sales and other purposes. The full extent of increased reserves associated with the discoveries at Elmworth must also await further planned development but preliminary work shows this could add over 500 billion cubic feet of gas reserves for Texaco Canada.

The company's reserve figures are believed to be reasonable estimates consistent with current knowledge of the reservoir characteristics and productive limits.

Development Drilling

	Number of wells			
	1978		1977	
	Gross	Net	Gross	Net
Oil	**8**	**3.9**	8	4.6
Gas	**79**	**10.7**	69	11.8
Dry	**4**	**1.6**	8	3.6
Total	**91**	**16.2**	85	20.0
% Productive	**96**	**90**	91	82

Estimated Proved Recoverable Reserves of Hydrocarbons as at the End of the Year

	Millions of barrels			
	1978		1977	
	Gross	Net	Gross	Net
Crude Oil	**440**	**299**	469	298
Gas Liquids	**99**	**72**	96	64
Total	**539**	**371**	565	362
Billions of cubic feet				
Natural Gas	**1,933**	**1,424**	1,893	1,301

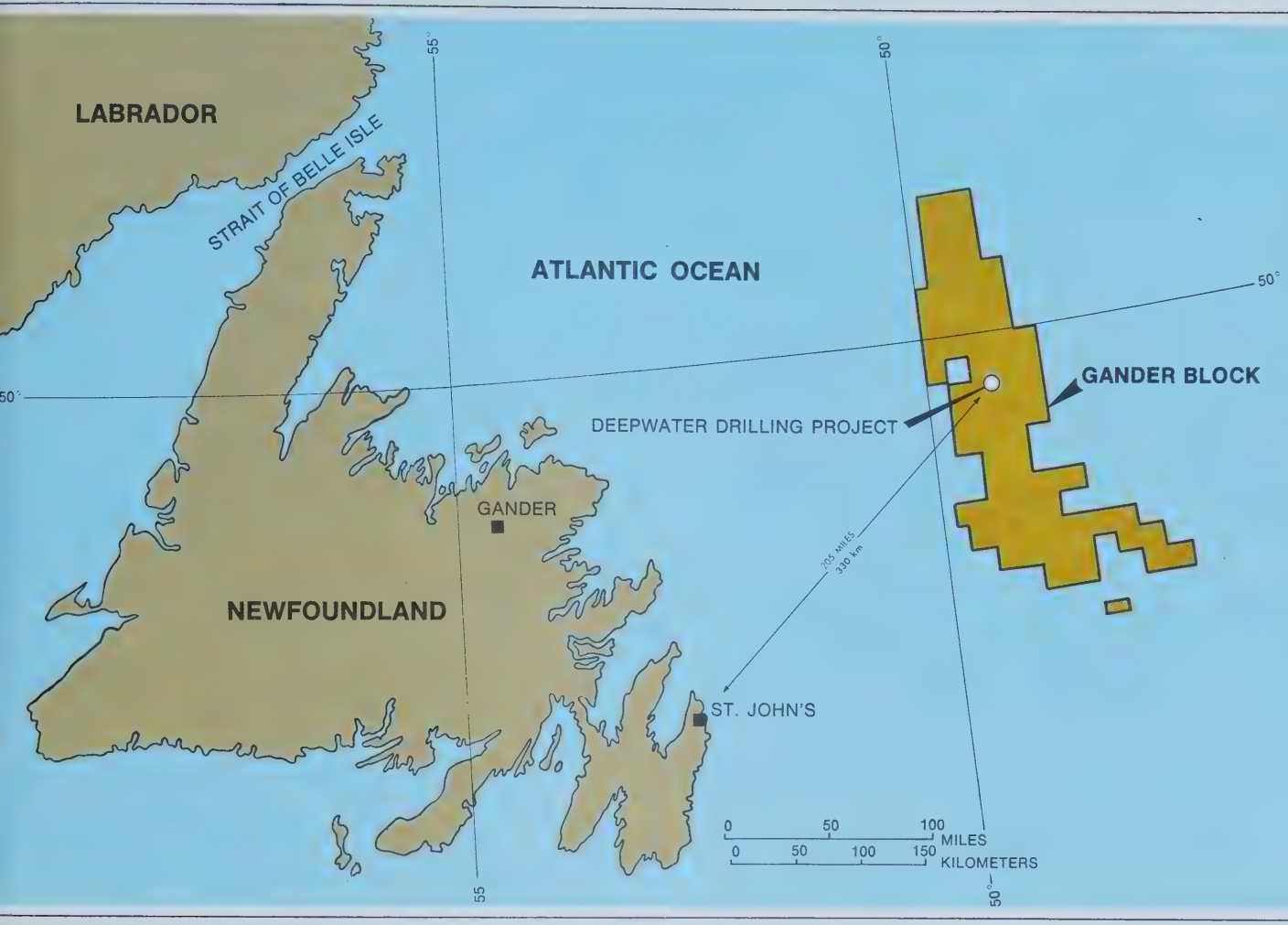
Net reserves are after the deduction of Royalties at rates in effect at the end of the applicable year.

Oil Sands

Operations in the company's experimental oil recovery project in the Athabasca oil sands near Fort McMurray, Alberta, have shown encouraging results during 1978. Since its commencement in 1972, about 360,000 barrels of heavy oil have been recovered.

This project is aimed at developing in-situ methods to recover heavy oil by production through wells at levels which are too deep to be surface mined. This type of recovery method may be necessary if the major portion of the vast heavy oil deposits at Athabasca and other locations in Alberta are to be recovered.

A number of recovery systems and combinations are being evaluated in the pilot operations. This continuing, extensive fundamental research into in-situ recovery technology could result in economic justification for a commercial project.



At year-end the company held 575,000 net acres of oil sand leases, containing an estimated 77 billion barrels of bitumen in place. These deposits at depths varying from 200 to 1,400 feet, must await development of economically viable recovery technology before any portion of them can be classified as proven reserves.

Coal

Texaco Canada holds approximately 128,000 acres of sub-bituminous coal leases in central Alberta. The coal beds range from 500 feet to 1,000 feet in depth and contain an estimated four billion tons in place. The company is participating with the Alberta Research Council in pilot testing of in-situ gasification processes, as opposed to underground mining, a possible means of developing this high grade future energy source.

Frontier Areas

Planning is well advanced for drilling a well offshore Newfoundland during 1979 in some 5,000 feet of water. This is the deepest water depth at which conventional exploratory drilling has ever taken place. Texaco Canada as the operator for a group of companies, has made arrangements to use the dynamically self-positioning drillship Discoverer Seven Seas, which currently holds the record for drilling a well in some 4,300 feet of water offshore Africa. The proposed well will be drilled on a five million acre farm-in from Shell Canada Resources Limited and Shell Explorer Limited. Approximate total depth is expected to be 19,000 feet below sea level.

Texaco Canada has about 1,421,000 gross acres under permit in the Beaufort Sea area. These holdings are under option to Dome Petroleum Limited, which is conducting drilling operations in the Beaufort Sea. It is anticipated that Dome will finalize the testing of some of its wells in this area during the summer of 1979 and then make a decision regarding drilling on the company's acreage to exercise their option.

Top: The 95,000 barrels per day Nanticoke refinery became operational in 1978 after four years of construction.

Right: Aerial view of the $480 million Nanticoke plant.

Opposite page: Nanticoke main control room monitors and controls refinery operations.

Refining

Crude runs at the company's refineries averaged 163,600 barrels daily, including the initial throughput at the new Nanticoke plant which went on stream in November 1978. This was an increase of 4% over the 157,500 barrels daily average in 1977.

The completion of the 95,000 barrels per day refinery at Nanticoke, after four years of construction at a total cost of about $480 million, provides the company with the ability to supply its increased market demand in Ontario without the need of costly supplementary supplies from other sources.

Following the start-up of this plant, crude running at the 48,000 barrels per day Port Credit, Ontario, refinery, was suspended. The petrochemical facilities there will continue to produce benzene, toluene, xylene and hexane using feedstocks supplied from the Nanticoke plant. The Port Credit facility will also be used as a sales terminal from which products, received by pipeline from Nanticoke, will continue to be distributed to the city of Toronto and other parts of Ontario.

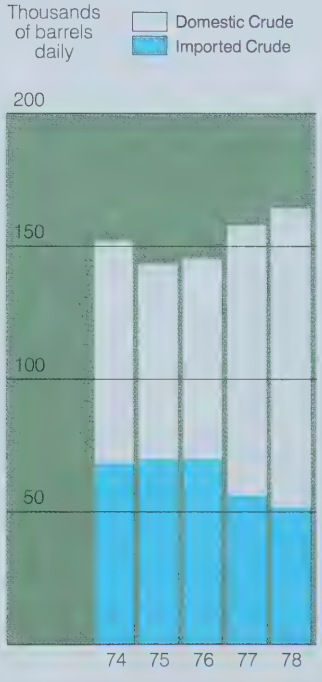
The capacity to manufacture high-octane gasoline blending stocks at Edmonton refinery was increased with the completion of modifications to the catalytic reforming unit. This will enable Texaco Canada to keep pace with the growing demand for lead-free gasolines in this market area. Modifications to the Montreal refinery, scheduled for completion in 1979, will also provide additional lead-free gasoline capacity in the market area served by that plant.

Nominal Crude Oil Capacity of Refineries as at December 31, 1978

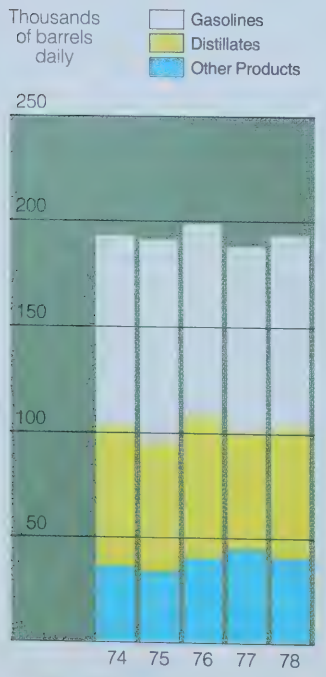
	Barrels Daily
Nanticoke, Ontario	95,000
Montreal, Quebec	74,500
*Port Credit, Ontario	48,000
Edmonton, Alberta	24,000
Halifax, Nova Scotia	20,000
Total	261,500

*Idle at year-end

Refinery Runs



Sales of Petroleum Products



Marketing

The market for petroleum products was intensely competitive throughout 1978, particularly in Eastern Canada where there is a large amount of under-utilized refining capacity. Consumer requirements rose by about 3% over the 1977 level.

The company's sales of petroleum products averaged 192,500 barrels a day for the year, an increase of 3% over 1977. Texaco Canada supplied nearly 13% of the motor gasoline marketed in Canada in 1978 and about 11% of all products.

Wholesale operations were further consolidated and many low volume service stations were eliminated as part of an ongoing program to improve distribution and reduce costs. The company had a total of some 3,500 retail outlets at year-end. The number of self-serve units was increased, however, in keeping with consumer requirements.

The introduction of Lead-free Sky Chief premium gasoline was begun in certain major markets late in the year. Also introduced during the year were new package designs for Havoline motor oil for the "do-it-yourself" market, and complete lines of Texaco branded automotive oil, air and gas line filters.

Texaco Canada's aviation products distributor, Innotech Aviation Limited, opened a new Sky Service facility at Ottawa International Airport at mid-year to serve the general aviation market. Other Texaco Sky Service centres are located at Vancouver, Calgary, Toronto, Montreal, and St. John's.

Conversion of the company's marketing operations to the metric system of measurement is expected to be completed before the end of 1980, following nearly two years of preparatory work.

Employee Relations

The company had 4,419 employees at year-end 1978, compared with 4,413 at the end of 1977. Payroll and benefit plan costs per employee amounted to $22,800 compared with $20,900, an increase of $1,900.

In 1978 the company provided a comprehensive program to assist employees as a result of the curtailment of operations, including those at Port Credit. This program included: early notification, reassignment of as many qualified employees to other jobs in Texaco Canada as possible, measures to help find other employment outside the company, and a voluntary Early Retirement Assistance Plan for those age 55 or older.

Twenty-four scholarships were awarded to sons and daughters of employees under the company's Merit Scholarship Plan bringing to 299 the number of scholarships awarded since the program started in 1966. Tuition reimbursements were provided to 131 employees under the education assistance program.

At year-end there were 740 employees with 25 or more years of service. Company pensioners numbered 575, an increase of 25 during 1978.

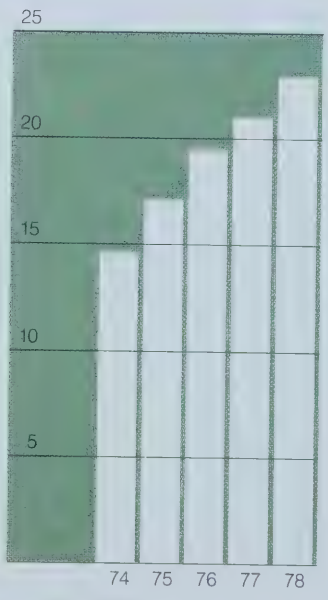
Left to right, across both pages:
New Operations Centre in Toronto uses advanced telecommunication equipment and systems to consolidate dispatching, maintenance control functions and related administrative activities.

Technician conducts home furnace combustion efficiency test.

New marina at Victoria, B.C., serves a variety of small craft.

Texaco lubricants are lifted aboard ship at Vancouver.

Salaries, Wages and Benefits per Employee



Texaco Chief captain charts course as officer checks position on radar.

Right: Nanticoke refinery employee operates valve sending product to market through Trans-Northern pipeline.

Public Affairs

A number of developments affecting the company and the oil and gas industry during 1978 resulted in a sharp increase in the level of communications activity involving Texaco Canada's publics, particularly employees, shareholders, customers, governments and the general public.

These developments included the amalgamation which resulted in the creation of Texaco Canada Inc., the completion and coming on-stream of the Nanticoke refinery, and the reduction in refinery operations and personnel at the Port Credit plant.

In addition, the company continued its ongoing program of two-way communications with students, educators, the news media and other groups.

Texaco Canada's views and positions were made known on a variety of important issues, including the proposed forced movement of Western Canadian natural gas into Eastern Canada, environmental regulations and schedules, and the need for government energy policies that encourage sufficient capital generation and investment in the search for new supplies.

The company provided support to educational, medical, health, cultural, social and community endeavours directly or through combined fund-raising appeals. The company also encouraged employees to contribute time and effort to worthwhile organizations and projects, particularly in communities where Texaco has major facilities.

For the enjoyment of Canadian home audiences, the company sponsored five live telecasts of Metropolitan Opera performances during 1978. Texaco Canada also began its 39th consecutive season of sponsoring Metropolitan Opera broadcasts on English and French language radio networks.

Description of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Texaco Canada Inc. and its subsidiary companies and are prepared in accordance with accounting principles generally accepted in Canada. Intercompany accounts and transactions are eliminated.

The premium paid on subsidiary companies' capital stock at date of acquisition is being amortized on a straight-line basis over twenty years.

Foreign currencies are translated into Canadian dollars as follows: (1) Current assets, except inventories, and current liabilities at the rate in effect at the end of the period; (2) inventories, properties, plant and equipment and related depreciation and deferred charges at the rate in effect when the assets were acquired; and (3) all other income accounts at rates in effect at the time of the transaction. Gains and losses on foreign currency transactions and charges and credits arising on translation of balance sheet accounts are reflected in income currently.

Inventories

Inventories of crude oil and petroleum products and other merchandise are stated at cost, determined on the first-in, first-out method, which, in the aggregate are valued lower than market. Materials and supplies are stated at cost.

Investments and Advances

The Corporation uses the equity method of accounting for its investments in companies owned 50%, and for all significant corporate joint ventures owned less than 50%. Under this method, the Corporation's equity in net earnings or losses of these companies is reflected currently in income rather than when realized through dividends. Investments in companies accounted for by this method reflect the Corporation's equity in the underlying net assets of the companies.

Investments in other non-subsidiary companies are carried at cost, and the Corporation's interest in the net earnings of these companies is reflected in net income when realized through dividends.

Properties, Plant and Equipment and Accumulated Depreciation, Depletion, and Amortization

All exploratory costs, including geophysical and geological expenses, core drilling, lease rentals, and intangible drilling costs applicable to dry holes are charged to expense as incurred.

Lease acquisition costs, intangible drilling costs on productive wells, and tangible equipment costs related to the development of oil and gas reserves are capitalized and amortized. For lease acquisitions costing less than one million dollars, the portion of leasehold costs estimated to be non-productive based upon historical experience, is amortized on an average holding period basis. For lease acquisitions costing more than one million dollars the portion of leasehold costs estimated to be non-productive, is amortized over the initial exploration period. Leasehold costs which have been determined to be productive and other development costs related to producing activities, including tangible and intangible costs are amortized on the

unit-of-production basis by applying the ratio of produced oil and gas to estimated recoverable oil and gas reserves.

Depreciation of properties, plant and equipment related to operations in Canada other than producing is provided generally on the group plan, using the straight-line method, with depreciation rates based upon estimated useful life applied to the cost of each class of property.

Start-up costs of new plants are capitalized and amortized in accordance with the Corporation's depreciation policy.

A wholly-owned foreign subsidiary has capital assets which are leased to an affiliated company. The cost of these assets is being depreciated over the term of the respective lease.

Normal maintenance and repairs are charged to expense as incurred. Renewals, betterments, and major repairs that materially extend the life of properties are capitalized and the assets replaced, if any, are retired.

Research and Development

Research and development costs are charged to income as incurred.

Deferred Income Taxes

Provision is made in the Corporation's accounts to reflect the income tax effect applicable to transactions recorded in the Corporation's financial statements in a reporting period different from the period in which they are reported for income tax purposes. The principal transactions are those related to depreciation, intangible drilling costs and leasehold costs.

Deferred income taxes as shown in the balance sheet represent the cumulative effect of net charges made against earnings to defer these income tax effects to appropriate future periods in the Corporation's financial statements. This accounting policy allocates the income tax effect of transactions to the period in which such transactions are recorded for financial reporting purposes.

Pension Plan

A group pension plan is available to substantially all employees. Amounts charged to pension expense are based on amortizing the cost of pension benefits on an actuarial basis over the remaining estimated service of the employees involved.

Federal Government Crude Oil Compensation Programs

Compensation received or recoverable under the programs for imported and for synthetic domestic oil for consumption in Canada is deducted from cost of crude oil purchases. In order to be eligible for compensation the Corporation has maintained selling prices in accordance with Federal Government guidelines and with the domestic crude oil allocation program.

Texaco Canada Inc. and Subsidiary Companies

Consolidated Statement of Income

for the years ended December 31, 1978 and 1977 (Dollars expressed in thousands except per share data)

	1978	1977
Gross Income		
Sales and services	$1,902,089	$1,710,175
Equity in net income of non-subsidiary companies (Note 2)	3,029	4,687
Dividends and interest	19,835	15,742
Other income	4,341	3,993
	$1,929,294	$1,734,597
Deductions		
Costs and operating expenses	$1,372,626	$1,207,654
Selling, general and administrative expenses	126,589	114,327
Dry hole costs	1,702	1,276
Depreciation, depletion, and amortization	33,601	27,376
Interest charges		
Long-term debt (Note 4)	10,834	10,844
Other	864	395
* Taxes, other than income taxes	93,247	85,380
	$1,639,463	$1,447,252
Income before Provision for Income Taxes	$ 289,831	$ 287,345
Provision for Income Taxes — current	43,313	104,187
— deferred	98,666	33,596
	$ 141,979	$ 137,783
Net Income	$ 147,852	$ 149,562
** Net income per common share	$4.19	$4.25

* In addition, federal excise tax, provincial motor fuel taxes collected from consumers were paid or accrued in the amounts of $296,777 during 1978, and $301,998 during 1977.

** Net income per common share based on average number of common shares outstanding was calculated after giving effect to the preferred dividends of the amalgamated company. Conversion of the first preferred shares, Series A, into common shares would not materially change the net income per common share.

See accompanying description of significant accounting policies and notes to consolidated financial statements.

Consolidated Statement of Retained Earnings

for the years ended December 31, 1978 and 1977 (Dollars expressed in thousands)

	1978	1977
Balance at beginning of year	$ 665,539	$ 564,083
Add —		
Net income	147,852	149,562
Deduct —		
Expenses related to amalgamation (net of income tax)	1,444	—
Dividends declared		
Preferred stock	12,717	150
Common stock	31,070	47,956
Balance at end of year	$ 768,160	$ 665,539

See accompanying description of significant accounting policies and notes to consolidated financial statements.

Texaco Canada Inc. and Subsidiary Companies

Consolidated Balance Sheet

December 31, 1978 and 1977 (Dollars expressed in thousands)

Assets	1978	1977
Current Assets		
Cash	**$ 29,660**	$ 11,537
Marketable securities, at cost which approximates market	**11,207**	10,000
Accounts and notes receivable		
Affiliated companies	**—**	166,510
Other	**252,521**	260,141
Inventories		
Crude oil and petroleum products and other merchandise	**197,783**	178,806
Materials and supplies	**7,079**	3,774
Prepaid expenses	**3,782**	4,354
Total current assets	**$ 502,032**	$ 635,122
Investments and Advances (Note 2)	**$ 35,823**	$ 35,245
Properties, Plant and Equipment (Note 3)	**$1,179,038**	$ 883,728
Deferred Charges		
Premium paid on subsidiary companies' capital stock, less amortization	**$ 1,548**	$ 1,406
Other	**3,989**	1,432
Total deferred charges	**$ 5,537**	$ 2,838
	$1,722,430	$1,556,933

See accompanying description of significant accounting policies and notes to consolidated financial statements.

Liabilities and Shareholders' Equity

	1978	1977
Current Liabilities		
Bank indebtedness, including $20,000 demand loan	$ —	$ 41,116
Long-term debt due within one year	26	24
Accounts payable and accrued liabilities		
Affiliated companies	20,655	17,305
Other	166,051	143,216
Sales, motor fuel and other taxes	40,069	41,360
Income taxes	10,175	30,343
Dividends payable	1,843	38
Total current liabilities	$ 238,819	$ 273,402
Long-Term Debt (Note 4)	$ 100,095	$ 100,121
Deferred Income Taxes	$ 288,241	$ 190,756
Shareholders' Equity		
Preferred Stock (Note 5)	$ 293,684	$ 293,750
Common Stock and Retained Earnings		
Common stock (Note 5)	$ 33,431	$ 33,365
Retained earnings	768,160	665,539
Total common stock and retained earnings	$ 801,591	$ 698,904
	$1,722,430	$1,556,933

Approved on behalf of the Board, February 16, 1979:

R. W. Sparks, Director

Neil M. Shaw, Director

Texaco Canada Inc. and Subsidiary Companies

Consolidated Statement of Changes in Financial Position

for the years ended December 31, 1978 and 1977 (Dollars expressed in thousands)

	1978	1977
Source		
Net income	$ 147,852	$ 149,562
Depreciation, depletion, and amortization	33,601	27,376
Provision for income taxes — deferred	98,666	33,596
Excess of equity in earnings of non-subsidiary companies over dividends (Note 2)	(162)	(1,592)
Provided by operations	$ 279,957	$ 208,942
Properties, plant and equipment retirements and sales	3,505	3,072
Other (net)	(3,115)	1,874
	$ 280,347	$ 213,888
Disposition		
*Properties, plant and equipment expenditures	$ 332,416	$ 209,558
Reduction in long-term debt (Note 4)	26	24
Expenses related to amalgamation	2,625	—
Cash dividends — preferred stock	12,717	150
— common stock	31,070	47,956
	$ 378,854	$ 257,688
Decrease in working capital	$ 98,507	$ 43,800
Working Capital		
At beginning of year	361,720	405,520
At end of year	$ 263,213	$ 361,720
*Properties, plant and equipment expenditures		
Producing	$ 52,838	$ 40,236
Manufacturing	94,488	151,267
Marketing	11,347	12,872
Marine	80	4,830
Pipelines	282	163
Capital assets leased to an affiliated company	173,043	—
Other	338	190
	$ 332,416	$ 209,558

See accompanying description of significant accounting policies and notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Dollars expressed in thousands)

1. Corporate Reorganization

Texaco Canada Inc. is the continuing company of the June 1, 1978 amalgamation of Texaco Canada Limited and Texaco Exploration Canada Ltd. The amalgamation was a corporate reorganization and has been accounted for in a manner similar to a pooling of interests. The consolidated financial statements for prior periods have been restated to reflect the effect of this amalgamation. In connection with this restatement, a uniform accounting method has been adopted for exploration costs, as described in the Description of Significant Accounting Policies.

The issued and outstanding shares of Texaco Canada Limited and Texaco Exploration Canada Ltd. at the date of the amalgamation were converted into shares of Texaco Canada Inc. as follows:

Texaco Canada Limited

All of the issued and outstanding Common Shares were exchanged share for share into 9,715,359 Common Shares.

All of the issued and outstanding Preferred Shares were converted share for share into 37,500 First Preferred Shares, Series A.

Texaco Exploration Canada Ltd.

The 1,000 issued and outstanding Common Shares were exchanged for 20,402,253 Common Shares, 1,700,000 Second Preferred Shares, Series A, and 1,200,000 Second Preferred Shares, Series B.

The paid-up capital of Texaco Canada Inc. is $327,115 made up as follows: First Preferred Shares, Series A — $3,684, Second Preferred Shares, Series A — $170,000, Second Preferred Shares, Series B — $120,000, and Common Shares $33,431. On amalgamation contributed surplus of $94,544 and retained earnings of $195,456 were capitalized.

2. Investments and Advances

	1978	1977
Non-subsidiary companies accounted for:		
On equity basis	**$17,484**	$17,314
At cost	**15**	481
	$17,499	$17,795
Miscellaneous investments (at cost)		
Notes, mortgages and other long-term receivables	**18,324**	17,450
Total investments and advances	**$35,823**	$35,245

3. Properties, Plant and Equipment

	Cost		Accumulated Depreciation, Depletion and Amortization	
	1978	1977	**1978**	1977
Producing	**$ 424,015**	$ 373,844	**$156,898**	$144,751
Manufacturing	**672,103**	577,849	**93,521**	88,476
Marketing	**233,377**	234,194	**95,201**	93,934
Marine	**19,951**	19,871	**2,743**	2,042
Pipelines	**10,383**	10,100	**5,098**	4,896
Capital assets leased to an affiliated company	**173,043**	—	**2,856**	—.
Other	**3,711**	3,132	**1,228**	1,163
	$1,536,583	$1,218,990	**$357,545**	$335,262
Net investment	**$1,179,038**	$ 883,728		

The new 95,000 barrels-a-day refinery at Nanticoke, Ontario, commenced operations in November, 1978.

On November 30, 1978 the Corporation announced that it had substantially reduced operations at its Port Credit refinery. The facility will continue limited production of petrochemicals and will be used as a product terminal. As at December 31, 1978, the undepreciated investment of the inactive segment of the Port Credit location is not significant. Management is continuing to pursue opportunities which may result in the resumption of crude oil processing at the Port Credit refinery.

4. Long-term Debt

Long-term debt at December 31, 1978 and 1977 is as follows:

	1978	1977
10¾% debentures, 1974 series, due 1994 ($5,000 annual sinking fund requirement 1980-1993)	**$100,000**	$100,000
Other	**95**	121
Total long-term debt	**$100,095**	$100,121

5. Capital Stock

	1978	1977
Preferred Stock		
First Preferred Shares		
Unlimited number of shares without nominal or par value, authorized and issuable in series:		
Series A — $6.00 cumulative, redeemable, convertible		
Issued—37,500 shares		
Outstanding		
1978, 36,840 shares, and 1977, 37,500 shares	**$ 3,684**	$ 3,750
Second Preferred Shares		
2,900,000 shares without nominal or par value, authorized and issued in series:		
Series A — $7.50 cumulative, redeemable Outstanding— 1,700,000 shares	**170,000**	170,000
Series B — $7.25 cumulative, redeemable Outstanding— 1,200,000 shares	**120,000**	120,000
Total Preferred Stock	**$293,684**	$293,750
Common Stock		
Common Shares		
Unlimited number of shares without nominal or par value and authorized:		
Issued and outstanding—1978, 30,118,932 shares, and 1977, 30,117,612 shares	**$ 33,431**	$ 33,365

First Preferred Shares, Series A, are redeemable at the Corporation's option upon a notice of not less than thirty days prior to the date fixed for redemption for an amount of $102.50 a share or can be purchased by the Corporation at a price not exceeding the redemption price of $102.50. The First Preferred Shares, Series A will not be redeemed or purchased by the Corporation before the first day of June 1983. These shares are convertible into fully paid and non-assessable common shares on the basis of two Common Shares for each First Preferred Share. During 1978, 660 shares were converted into 1,320 Common Shares.

Second Preferred Shares, Series A, are redeemable at $100.00 a share on the last day of February, May, August and November in each twelve-month period after June 1, 1984. The Corporation shall not call for redemption, redeem, purchase or otherwise retire for value any Second Preferred Shares, Series A, at any time when any Second Preferred Shares, Series B, are outstanding unless contemporaneously therewith it shall call for redemption and redeem, purchase or otherwise acquire all outstanding Second Preferred Shares, Series B. At the option of the holders 400,000 shares may be redeemed each twelve-month period from June 1, 1984 through 1986 and 500,000 shares each twelve-month period thereafter. If certain dividend and working capital tests are met, the number of shares which may be redeemed at the option of the holders can be increased to 800,000 each twelve-month period from June 1, 1984 through 1986 and to 900,000 each twelve-month period thereafter.

Second Preferred Shares, Series B, are redeemable at $100.00 a share. There is a mandatory redemption on the last day of February and May commencing in 1982 and each year thereafter for a total of 400,000 shares each year. Subject to certain dividend and working capital tests being met, redemption may be accelerated at the option of the holders for an additional 400,000 shares after June 1, 1981 and each twelve-month period thereafter.

The Corporation shall not solely at its own option redeem or purchase any Second Preferred Shares on or before June 1, 1988.

6. Pension Plan

As at December 31, 1978, costs which will be incurred in future years in respect of prior service amounted to approximately $8,538 on a present value basis. These costs are being funded by annual payments of $1,116 which will substantially amortize the liability by 1989.

7. Commitments and Contingent Liabilities

As at December 31, 1978, the Corporation had non-cancellable leases expiring more than one year from such date covering service stations, office buildings and other facilities. Minimum amounts payable under such commitments without reduction for related rental income are expected to average approximately $9,700 annually for the next five years.

Under certain service station lease agreements, the Corporation is contingently liable as guarantor for loans by third parties to the lessors which total $20,265 as at December 31, 1978. Annual payments due for the five years commencing 1979 by the lessors are: $4,909, $3,880, $3,954, $4,032, and $4,114. The Corporation has an option to purchase certain service stations for the outstanding amount of the contingent liability.

Under long-term agreements with pipeline companies, the Corporation guarantees specified revenue from crude and refined products shipped. The Corporation may be required to advance funds against future transportation charges to certain companies in which stock interests are held, in the event such companies are unable to meet specific debt obligations. The contingent liability arising from such agreements together with certain liabilities on discounted notes, etc., amount to $30,548 at December 31, 1978.

No losses are anticipated by reason of the above contingent obligations. In the opinion of the Corporation's General Counsel, while it is impossible to ascertain the ultimate legal and financial liability with respect to other contingent liabilities, including lawsuits, income taxes, claims, guarantees, etc., the aggregate amount of such liability is not materially significant in relationship to the total consolidated assets of the Corporation and its subsidiaries.

At December 31, 1978, the Corporation is contractually liable to make payments, aggregating not less than $7,300 under a "process or pay" agreement granting the Corporation the right to process specified volumes of crude oil.

8. Federal Government Anti-Inflation Legislation

The Corporation has complied with all legal restraints from the inception of the Federal Government's anti-inflation legislation, and is in compliance in all activities relative to prices, profits, dividends, and compensation. The Anti-Inflation Act expired December 31, 1978.

9. Supplementary Information

In December 1978, the Canadian Institute of Chartered Accountants issued a recommendation for methods of accounting for lease transactions (other than those pertaining to the rights to explore and develop natural resources) entered into during fiscal years commencing on or after January 1, 1979. Had the accounting principle been in effect in 1978, the following accounts in the Corporation's financial statements would have reflected the following retroactive adjustments for capital leases and direct financing leases in existence at December 31, 1978.

Consolidated Balance Sheet	As Reported on 1978 Financial Statements	Adjustment	Restated
Prepaid expenses	**$ 3,782**	$ (112)	$ 3,670
Investments and advances	**35,823**	163,647	199,470
Properties, plant and equipment	**1,179,038**	(123,056)	1,055,982
Long-term capital lease obligation due within one year	—	11,615	11,615
Accounts payable and accrued liabilities			
Affiliated companies	**20,655**	(598)	20,057
Other	**166,051**	314	166,365
Long-term capital lease obligation	—	28,868	28,868
Deferred income taxes	**288,241**	(4,199)	284,042
Retained earnings	**768,160**	4,479	772,639
Consolidated Statement of Income—Year 1978			
Net income	**$ 147,852**	$ 6,240	$ 154,092
Net income per common share	**$4.19**		$4.40

Rental expense for capital lease properties will be reflected in the Corporation's income statement as interest expense and amortization of the property cost. Rental income from direct financing leases will be segregated between interest income and amortization of long-term receivables.

Auditors' Report

To the Shareholders,
Texaco Canada Inc.:

We have examined the consolidated balance sheet of Texaco Canada Inc. and subsidiary companies as of December 31, 1978 and 1977, and the related consolidated statements of income, retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Texaco Canada Inc. and subsidiary companies as of December 31, 1978 and 1977, and the results of their operations and changes in their financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis during the years.

Arthur Anderson & Co.,
Chartered Accountants

Toronto, Ontario
February 16, 1979.

Five Year Review

(Dollars expressed in millions, except where noted)

	1978	1977	1976	1975	1974
Financial Summary					
Gross income	**$1,929.3**	$1,734.6	$1,606.2	$1,558.6	$1,433.5
Net income	**147.9**	149.6	104.5	130.4	153.8
Per common share (dollars)	**4.19**	4.25	2.75	3.61	4.39
Per dollar of gross income (cents)	**7.7**	8.6	6.5	8.4	10.7
* Dividends paid or accrued					
Common shares	**31.1**	48.0	19.0	23.9	17.7
First preferred shares	**0.2**	0.2	0.2	0.2	0.2
Second preferred shares					
Series A	**7.4**	—	—	—	—
Series B	**5.1**	—	—	—	—
Funds flow					
Provided by operations	**280.0**	208.9	169.7	185.5	189.5
Per common share (dollars)	**9.30**	6.94	5.63	6.16	6.29
Capital and exploratory expenditures	**353.8**	221.4	189.4	167.9	102.7
Taxes paid or accrued and deferred income taxes					
Provision for current and deferred income taxes	**142.0**	137.8	115.7	126.5	111.1
Crown royalties, import duties and other levies	**166.3**	142.4	115.3	104.0	91.4
Taxes other than income taxes	**93.2**	85.4	73.8	66.3	50.2
Taxes collected from consumers	**296.8**	302.0	306.8	265.6	204.7
Total	**698.3**	667.6	611.6	562.4	457.4
Financial Condition at Year-End					
Current assets	**$ 502.0**	$ 635.1	$ 574.3	$ 619.2	$ 602.7
Current liabilities	**238.8**	273.4	168.8	192.0	192.5
Working capital	**263.2**	361.7	405.5	427.2	410.2
Properties, plant and equipment—net	**1,179.0**	883.7	704.6	557.9	440.1
Investments, long-term receivables and other assets	**41.4**	38.1	38.4	39.7	39.3
Capital employed	**1,483.6**	1,283.5	1,148.5	1,024.8	889.6
Long-term debt	**100.1**	100.1	100.1	100.2	100.2
Deferred income taxes	**288.2**	190.7	157.2	118.7	89.9
Shareholders' equity					
Preferred	**293.7**	293.8	293.8	293.8	293.8
Common	**801.6**	698.9	597.4	512.1	405.7
Equity per common share	**26.61**	23.21	19.84	17.00	13.47
Return on average capital employed	**11.5**	13.2	10.6	14.8	20.1

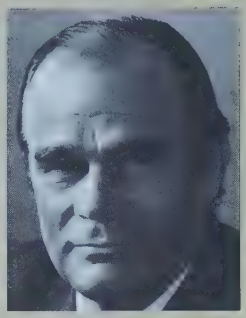
* Since June 1, 1978 the annual rate of dividend on Common Shares has been $1.56 per share, payable $0.39 quarterly. The annual rate of dividend on the First Preferred Shares, Series A, has been $6.00 per share, payable $1.50 quarterly, on Second Preferred Shares, Series A, has been $7.50 per share, payable $1.875 quarterly, and on Second Preferred Shares, Series B, has been $7.25 per share, payable $1.8125 quarterly.

	1978	1977	1976	1975	1974
Operations Summary					
(In thousands of barrels daily)					
Production of crude oil and natural gas liquids					
Gross	**122.8**	123.6	124.4	138.2	178.0
Net	**82.0**	83.6	85.8	95.6	126.1
Refinery runs	**163.6**	157.5	145.1	143.0	151.8
Refinery crude oil capacity at year-end	**261.5**	163.5	161.5	160.0	160.0
Petroleum product sales	**192.5**	187.6	198.4	191.2	192.7
Natural gas sales (millions of cubic feet daily)	**71.5**	85.7	87.3	86.0	88.0
Number of wells drilled					
Gross	**119**	107	63	107	81
Net	**31.2**	31.8	21.4	33.4	41.5
Estimated gross proved recoverable reserves					
Oil (million barrels)	**538.9**	565.4	665.9	708.8	757.9
Gas (billion cubic feet)	**1,933**	1,893	1,947	1,945	1,994
Share Ownership					
Number of common shares outstanding at year-end	**30,118,932**	30,117,612	30,117,612	30,117,612	30,117,612
Number of common shareholders at year-end	**4,210**	4,664	4,814	5,036	5,197
Number of first preferred shares outstanding at year-end	**36,840**	37,500	37,500	37,500	37,500
Number of first preferred shareholders at year-end	**493**	534	565	589	596
Employees					
Number at year-end	**4,419**	4,413	4,418	4,441	4,429
Payroll and benefits	**$101.9**	$91.6	$85.8	$75.3	$64.9

As stated in Note 1 of the Notes to Consolidated Financial Statements, Texaco Canada Limited and Texaco Exploration Canada Ltd. were amalgamated June 1, 1978 in a manner similar to a pooling of interest. Consequently, the previously reported figures have been restated to reflect the effect of this amalgamation.

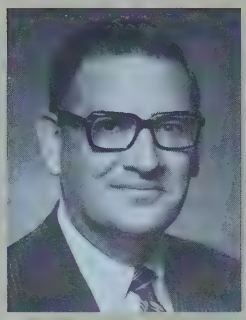
Directors of Texaco Canada Inc.

William S. Barrack, Jr.
Vice-President
Personnel and Corporate Services
Texaco Inc.
White Plains, New York

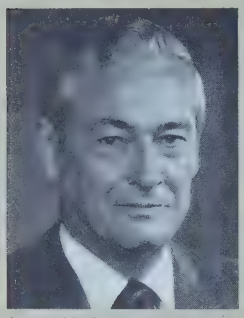


*Rodrigue J. Bilodeau
Chairman of the Board and Chief Executive Officer
Honeywell Limited
Toronto

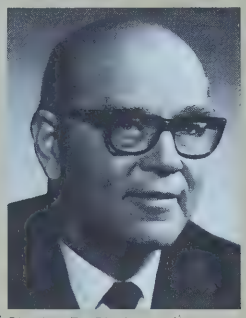
Jacques Bock
President and General Manager
Bock and Tétreau Inc.
Montreal



James E. Brazell
Executive Vice-President
Texaco Canada Inc.
Toronto



⁂ Annon M. Card
Senior Vice-President
Texaco Inc.
White Plains, New York



⁂ Stanley D. Clarke
President
Clarke Transport Canada Inc.
Montreal

A. G. Farquharson
Retired, Formerly President and Chief Executive Officer
Texaco Canada Limited
Bainsville, Ontario

⁂ H. J. Lang
Chairman
Canron Inc.
Toronto

*J. Lee Morrison
Executive Vice-President
Texaco Canada Inc.
Toronto

Paul Murdock
President
Murdock Lumber Inc.
Chicoutimi, Quebec

The Hon. Victor deB. Oland
Chairman
Lindwood Holdings Limited
Halifax

**Charles I. Rathgeb
Chairman and Chief Executive Officer
Comstock International Ltd.
Toronto

F. Augustus Seamans
Vice-President
Exploration and Producing Services
Texaco Inc.
Houston, Texas

**Neil M. Shaw
President and Chief Executive Officer
Redpath Industries Limited
Toronto

⁂ R. W. Sparks
President and Chief Executive Officer
Texaco Canada Inc.
Toronto

William K. Tell, Jr.
Senior Vice-President
Texaco Inc.
Washington, D.C.

*Member of the Executive Committee

**Member of the Audit Committee

Other Senior Officials

O. C. Cleyn
Vice-President, Eastern Canada and Region Manager

A. J. Galipeault
Vice-President and General Counsel

H. T. Hudson
Vice-President and Assistant to the President

D. E. Hyer
Vice-President and General Manager, Exploration and Producing

G. T. Plunkett
Vice-President and Treasurer

J. C. Wattie
Vice-President, Corporate Planning and Services

E. J. Little
Secretary

D. L. West
Comptroller

O. C. Windrem
Corporate Tax Officer

R. M. Clifford
General Manager, Employee Relations

L. W. Kennedy
General Manager, Refining

N. E. Taylor
General Manager, Marketing

S. J. Walker
General Manager, Supply and Distribution

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Address by R. W. Sparks, President and Chief Executive Officer of Texaco Canada Limited, to the Annual and Special General Meetings of the company, Inn on the Park, Toronto, May 23, 1978

MAY 25 1978

It is our custom at the Annual Meeting of Shareholders of Texaco Canada Limited to review the financial results and operations for the previous year as well as the first quarter of the current one, and to comment at some length on the conditions and outlook for the petroleum industry in Canada.

But today - because of the heavy agenda relating to the amalgamation proposal and other matters that will be brought before the common and preferred shareholders - I will keep my remarks as brief as possible.

Results for 1977

In the Annual Report you will have seen that our company's consolidated net income in 1977 amounted to $36.7 million, equal to $3.76 a share - - an increase of 26.5% over 1976.

This improvement was due principally to higher revenues from increased prices for crude oil and natural gas liquids, greater sales of natural gas, and improved operating efficiencies. (It was achieved in spite of the considerable downward pressure on earnings that was exerted particularly by moderating consumer demand for some products and generally weak product prices in the marketplace).

1977 was a significant and memorable year for the company in several respects.

December 21 marked the 50th anniversary of the incorporation under federal charter of McColl-Frontenac Oil Company Limited, the corporate name of which was changed to Texaco Canada Limited in 1959. This milestone served to remind us of the extent and scope of our corporate growth and progress during those intervening years. From a relatively small eastern Canadian refining and marketing company with gross revenues of $10 million and assets of nearly $21 million in its first year, we grew into an integrated, Canada-wide major petroleum company whose gross income and assets both exceeded the $1 billion mark in 1977. This important anniversary was also an occasion to pause and reflect not only on the accomplishments of so many dedicated employees over the years but also on the long and proud history of this company as a corporate citizen of Canada - - the origins of which go back to 1873, only six years after Confederation.

More complete and graphic descriptions and illustrations of the company's development to date are contained in the commemorative supplement that appears in the Annual Report as well as in the special 50th Anniversary display stands that you may have noticed at the back of this room. I commend both to your attention and believe you will find them interesting.

With respect to Texaco Canada's operations during 1977, I would like to mention in particular the three-fold increase in our exploration and production expenditures. Most of this increase was for exploration, drilling and further land acquisitions in the Elmworth and West Pembina areas where unique opportunities became apparent.

The company's exploratory drilling results have been quite encouraging in the Elmworth area where substantial gas reserves are indicated. Additional drilling is planned during the balance of 1978 to further delineate reserves. The company recently entered into a contract with Trans-Canada Pipelines to sell substantially all of its share of this gas beginning in late 1979. The company's holdings in the general area including Elmworth total almost 167,000 net acres.

Texaco Canada has a much smaller stake in West Pembina amounting to about 4,300 net acres, which arise principally from its 5% to 10% interests in some 48,800 acres in this area. This acreage appears well located in relation to recent oil discoveries, two of which have been drilled on 5% interest lands. We are currently participating in some 4 additional exploratory wells in this area.

Results for First Quarter of 1978

The company's earnings for the first quarter of 1978 were announced publicly on April 25. Estimated net income was $6,370,000 or 65 cents a share, compared with $9,571,000 or 98 cents a share in the same period in 1977. Gross income amounted to $315,170,000 compared with $279,960,000.

The higher gross revenues were due almost entirely to increases in crude prices.

The decline in net income was due to a combination of factors. Heavy downward pressure on product prices prevented full recovery of higher crude oil and other costs. The effects of

comparatively milder weather conditions on heating oil sales, coincident with moderating consumer demand, resulted in decreased refining and marketing operations. Production of crude oil and natural gas liquids declined as a result of further reductions in exports to United States markets. Greater borrowing costs to finance the new Nanticoke refinery and higher cost inventories also had an adverse effect on income.

During the first quarter we continued our efforts to reduce costs and achieve higher levels of efficiency in our operations.

While these efforts have resulted in significant contributions to earnings they have not, and cannot be expected to, fully offset the continuing deterioration of petroleum product prices in the marketplace.

The substantial excess refining capacity in central and eastern Canada, which is one of the root causes of weak prices, has resulted from government imposed trade barriers and moderating growth in demand. It is to be hoped that both the Canadian and U.S. governments will recognize the value to both countries of rational use of this spare capacity. Canada could and should obtain the value-added benefits of processing crude oil for those U.S. markets where consumer cost benefits are evident.

Outlook for the Industry

Before proceeding to the other business still before us today I would like to say a few words about the outlook for our industry.

As indicated in the Annual Report, we expect that production of liquid hydrocarbons in Canada in 1978 will decline slightly from the 1977 level to about 1,600,000 barrels daily. This reflects a further decrease in exports of these raw materials to markets in the United States. Domestic demand for petroleum products, however, should increase by about 3-1/2% to a level of about 1,870,000 barrels daily. Sales of natural gas to domestic and export markets should be approximately 6.6 billion cubic feet daily - about the same as in 1977.

We also expect in 1978 a continuance of the high level of exploration which highlighted petroleum activity in 1977, when a number of important oil and gas discoveries were made in Alberta. Although these are in the early stages of development, it can be reasonably assumed that they will have a positive effect on Canada's reserve position and productive capacity.

These discoveries, combined with a more moderate growth in consumption, have resulted in an improvement in Canada's petroleum supply outlook.

To meet Canada's longer term energy requirements will, however, necessitate an all-out effort by the petroleum industry to find and develop additional supplies of oil and gas. Such an

effort by the industry will, in turn, require federal and provincial government policies that are realistic and permit an adequate return on investments.

Bearing in mind that the essential goal of an energy policy must be to ensure that Canadians are provided with adequate and reasonably priced energy on an ongoing basis, there is an overriding need for a shift in emphasis by governments away from regulation and towards greater economic incentives.

One of the most urgent current issues that must be dealt with, for instance, is finding markets for surplus Western Canadian natural gas without causing severe and costly disruption of refinery balances in Eastern Canada and creating still more idle capacity.

Various propositions are being advanced that would result in substituting very large quantities of natural gas for residual oil in Quebec and the Atlantic Provinces as a means of finding markets for surplus western gas - - while at the same time reducing crude oil imports and thereby helping Canada's balance of payments position. One scheme that was supported recently by a federal government spokesman is to construct a natural gas pipe line from Montreal to the east coast.

We believe that the disadvantage inherent in such a so-called "solution" would outweigh the advantages.

Natural gas cannot compete in price with heavy fuel or burning oils in Quebec or the Atlantic region under present

marketing conditions. As natural gas prices rise to parity with crude oil, this disadvantage will increase. Construction costs for new or expanded transmission and distribution facilities would result in even wider cost discrepancies. Furthermore, the force-feeding of natural gas would result in severe and costly disruptions to the existing refining and product distribution system in eastern Canada and create an additional financial burden to be borne by the consumer and taxpayer - - at a time when inflationary pressures remain high.

There are simpler and less expensive ways of using surplus western gas and alleviating Canada's balance of payments problems. One such measure - - provided Canada acts soon enough - - would be to sharply increase short term gas exports to the United States' West Coast and Midwest. The conditions tied to such exports could provide for repayment "in kind" if Canada's supplies run low.

Another feasible and constructive measure, I believe, would be to materially increase the flow of Western Canadian crude oil to Montreal for consumption in Eastern Canadian markets. It would be more logical to do this than to force natural gas into these markets. Not only is oil more economical for the eastern consumer, but this additional crude could be moved almost immediately by increasing the pumping capacity of existing oil pipeline systems at little extra cost, compared with the enormous cost and the time lag that would be involved in constructing a natural gas pipe line as well as all the distribution facilities required in the markets to be served.

Such additional consumption of Canadian oil in the east would result in increased production, thus generating at the producing end more of the funds necessary to conduct the search for and development of new oil and gas reserves. In addition, this would help improve Canada's increasingly unfavourable energy balance of payments position by reducing imports of foreign oil. Such increased movement of domestic crude to Montreal is, moreover, feasible, considering that Canada now has a large shut-in crude production capacity.

Both the federal and provincial governments have recently indicated a better understanding of industry needs. For example, the introduction of improved incentives for exploration and development of petroleum resources in Canada. We hope that they will give serious consideration to the suggestion which I have made today and not embark on a course of action in connection with natural gas which will prove to be more costly to the consumer and more disruptive to the hard pressed petroleum industry.